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ABSTRACT

Designed for the general public and possibly suitable also for high school economics students, this booklet briefly explains the terminology associated with general economic concepts about banking and the Federal Reserve System. Part 1 deals with financial regulators and institutions, including nondeposit intermediaries and depository intermediaries. Part 2 presents terms related to monetary policy, particularly those dealing with open market policy, discount policy, and reserve requirements. Part 3 deals with the nation's payments mechanism and includes terminology related to the distribution of currency and coin, check processing, wire transfer of funds, and the operation of automated clearinghouses that transfer funds electronically among depository institutions. The terms in Part 4 describe foreign banking transactions and institutions. Over 30 terms dealing with consumer credit, such as annual percentage rate, open-end credit, balloon payment, buydown, amortization, fixed rate, graduated payment, and negative amortization are described in the final section. (LH)

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introduction

Public understanding of the responsibilities of the Federal Reserve System is sometimes made difficult by the terms used in discussing the financial system. Some of the terminology relates to general economic concepts; some originates in banking; and some relates uniquely to the Federal Reserve.

These days, it would be quite reasonable for an expert in "EFTS" to inform a co-worker that he used a "debit card" at an "ATM" to get money to buy a tennis racket. This glossary will help to translate this and other statements about our financial system.

Board of Governors of the
Federal Reserve System
Washington, D.C. 20551

Revised November, 1982

financial regulators and institutions

Federal Reserve System — The central bank of the United States created by Congress and consisting of a seven member Board of Governors in Washington, D.C., 12 regional Reserve Banks, and depository institutions that are subject to reserve requirements. All national banks are members; state-chartered banks may elect to become members, and state members are supervised by the Board of Governors and the Reserve Banks. Approximately 37 percent of all banks are member banks, including most large banks. Reserve requirements established by the Federal Reserve Board apply to nonmember depository institutions as well as member banks. Both classes of institutions are given access to Federal Reserve discount borrowing privileges and Federal Reserve services on an equal basis.

Comptroller of the Currency — An officer of the Treasury Department, the Comptroller of the Currency is responsible for chartering national banks and has primary supervisory authority over them. All national banks are required to be members of the Federal Reserve System and are insured by the Federal Deposit Insurance Corporation.

Federal Deposit Insurance Corporation (FDIC) — Agency of the federal government that insures accounts at most commercial banks and mutual savings banks. The FDIC also has primary federal supervisory

authority over insured state banks that are not members of the Federal Reserve System.

Federal Home Loan Bank Board (FHLBB) The agency of the federal government that supervises all federal savings and loan associations and federally insured state-chartered savings and loan associations. The FHLBB also operates the Federal Savings and Loan Insurance Corporation, which insures accounts at federal savings and loan associations and those state-chartered associations that apply and are accepted. In addition, the FHLBB directs the Federal Home Loan Bank System, which provides a flexible credit facility for member savings institutions to promote the availability of home financing. The FHL Banks also own the Federal Home Loan Mortgage Corporation, established in 1970 to promote secondary markets for mortgages.

National Credit Union Administration (NCUA) The federal government agency that supervises, charters, and insures federal credit unions. NCUA also insures state-chartered credit unions that apply and qualify for insurance. The NCUA also operates a credit facility for member credit unions.

Depository Institutions Deregulation Committee (DIDC) The Committee responsible for the orderly phase-out over a six-year period of interest rate ceilings on time and savings accounts at depository institutions. Voting members of the DIDC are the Secretary of the Treasury and the Chairmen of the Federal Reserve Board, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, and National Credit Union Administration Board. The Comptroller of the Currency serves as a nonvoting member.

Financial Institution An institution that uses its funds chiefly to purchase financial assets (deposits, loans, securities) as opposed to tangible property. Financial institutions can be classified according to the nature of the principal claims they issue: nondeposit intermediaries include, among others, life and property/casualty insurance companies and pension funds, whose claims are the policies they sell, or the promise to provide income after retirement; depository intermediaries obtain funds mainly by accepting deposits from the public. The major depository institutions are listed below. Although historically they have specialized in certain types of credit, the powers of nonbank depository institutions have been broadened in recent years. For example, NOW accounts, credit union share drafts, and other services similar to checking accounts may be offered by thrift institutions.

Commercial Banks are allowed to engage in more varied lending activities and to offer more financial services than are the other depository institutions. Commercial banks are owned by stockholders and operated for profit.

Savings and Loan Associations, also sometimes called building and loan associations, cooperative banks, or homestead associations, accept deposits primarily from individuals, and channel their funds primarily into residential mortgage loans. Most savings and loan associations are technically owned by the

depositors who receive shares in the association for their deposits.

Mutual Savings Banks also accept deposits primarily from individuals, and place a large portion of their funds into mortgage loans. These institutions are prominent in many of the northeastern states. Savings banks generally have broader asset and liability powers than savings and loan associations but narrower powers than commercial banks. Savings banks are authorized to offer checking-type accounts.

Credit Unions are financial cooperative organizations of individuals with a common affiliation (such as employment, labor union membership, or place of residence). Credit unions accept deposits of members, pay interest (dividends) on them out of earnings, and primarily provide consumer instalment credit to members.

Thrift Institution is a general term often used for mutual savings banks, savings and loan associations, and credit unions.

Member Bank — A depository institution that is a member of the Federal Reserve. All national banks are required to be System members, and state-chartered commercial banks and mutual savings banks may elect to become members. Member banks own stock in Federal Reserve Banks and elect Reserve Bank directors.

Nonmember Depository Institution — A depository institution (commercial bank, mutual savings bank, savings and loan association, credit union, or U.S. agency or branch of a foreign bank) that is not a member of the Federal Reserve System. Nonmember depository institutions that offer transaction accounts or nonpersonal time deposits are subject to reserve requirements set by the Federal Reserve, and they also have access to the Federal Reserve discount window and Federal Reserve services on the same terms as member banks.

Correspondent Bank — A bank that accepts deposits of and performs banking services for other depository institutions.

Bank Holding Company — A company that owns or controls one or more banks. The Board of Governors has responsibility for regulating and supervising bank holding companies, such as approving acquisitions and mergers and inspecting the operations of such companies. This authority applies even though a bank owned by a holding company may be under the primary supervision of the Comptroller of the Currency or the FDIC.

Permissible Nonbank Activities — Financial activities closely related to banking that may be engaged in by bank holding companies, either directly or through nonbank subsidiaries. Examples are owning finance companies and engaging in mortgage banking. The Board determines which activities are closely related to banking. Before making such activities permissible, the Board must also determine that performance of the activities by bank holding companies is in the public interest.

Grandfathered Activities — Nonbank activities, some of which would normally not be permissible for bank holding companies and foreign banks in the United States, but which were ac-

quired or engaged in before a particular date. Such activities may be continued under the "grandfather" clauses of the Bank Holding Company Act and the International Banking Act.

Edge Act Corporation An organization chartered by the Federal Reserve to engage in international banking operations. The Board acts upon applications by U.S. and foreign banking organizations to establish Edge corporations. It also examines Edge corporations and their subsidiaries. The Edge corporation gets its name from Senator Walter Edge of New Jersey, the sponsor of the original legislation to permit formation of such organizations.

Agreement Corporation An Agreement corporation is a federally or state-chartered corporation that has entered into an agreement or understanding with the Board that it will not exercise any power that is impermissable for an Edge corporation.

Cease-and-Desist Order An order issued after notice and opportunity for hearing, requiring a depository institution, a holding company, or a depository institution official to terminate unlawful, unsafe or unsound banking practices. Cease-and-desist orders are issued by the appropriate federal regulatory agencies under the Financial Institutions Supervisory Act and can be enforced directly by the courts.

The Depository Institutions Deregulation and Monetary Control Act of 1980 (MCA) Among its major provisions, this Act applied uniform reserve requirements to all depository institutions with certain types of accounts and required reports from these depository institutions. It also extended access to the Federal Reserve discount window and to other Federal Reserve services in step with the implementation of a fee schedule.

Bank Supervision Concern of financial regulators with the safety and soundness of individual banks, involving the general and continuous oversight of the activities of this industry to ensure that banks are operated prudently and in accordance with applicable statutes and regulations.

Bank Regulation The formulation and issuance by authorized agencies of specific rules or regulations, under governing law, for the conduct and structure of banking.

monetary policy

Money Anything that serves as a generally accepted medium of exchange, a standard of value, and a means to save or store purchasing power. In the U.S., paper currency (nearly all of which consists of Federal Reserve notes), coin and funds in checking and similar accounts at depository institutions are examples of money.

Monetary Policy Federal Reserve actions to influence the availability and cost of money and credit, as a means of helping to promote high employment, economic growth, price stability, and a sustainable pattern of international transactions. Tools of monetary policy include open market operations, discount policy, and reserve requirements.

Money Stock

M1 — The sum of currency held by the public, plus travelers' checks, plus demand deposits, plus other checkable deposits (i.e., negotiable order of withdrawal [NOW] accounts, and automatic transfer service [ATS] accounts, and credit union share drafts.)

M2 — M1 plus savings accounts and small-denomination time deposits, plus shares in money market mutual funds (other than those restricted to institutional investors), plus overnight Eurodollars and repurchase agreements.

M3 — M2 plus large-denomination time deposits at all depository institutions, large denomination term repurchase agreements, and shares in money market mutual funds restricted to institutional investors.

Federal Open Market Committee (FOMC)

A 12 member committee consisting of the seven members of the Federal Reserve Board and five of the twelve Federal Reserve Bank presidents. The president of the Federal Reserve Bank of New York is a permanent member while the other Federal Reserve presidents serve on a rotating basis. The Committee sets objectives for the growth of money and credit that are implemented through purchases and sales of U.S. Government securities in the open market. The FOMC also establishes policy relating to System operations in the foreign exchange markets.

Open Market Operations

Purchases and sales of government and certain other securities in the open market by the New York Federal Reserve Bank as directed by the FOMC in order to influence the volume of money and credit in the economy. Purchases inject reserves into the depository system and foster expansion in money and credit; sales have the opposite effect. Open market operations are the Federal Reserve's most important and most flexible monetary policy tool. They are used to promote either higher or lower growth in money and credit and to offset undesired changes in the reserve positions of depository institutions stemming from movements in currency, float, Treasury deposits, and other factors.

The Desk

The trading desk at the New York Federal Reserve Bank, through which open market purchases and sales of government and federal agency securities are made. The desk maintains direct telephone communication with major government securities dealers. A "foreign desk" at the New York Federal Reserve Bank conducts transactions in the foreign exchange market.

Discount Window

Figurative expression for Federal Reserve facility for extending credit directly to eligible depository institutions (those with transaction accounts or nonpersonal time deposits). In the early years of the System, bankers came to a Reserve Bank teller window to obtain credit.

Discount Rate

The interest rate at which eligible depository institutions may borrow funds, usually for short periods, directly from the Federal Reserve Banks. The law requires the board of directors of each Reserve Bank to establish the discount rate every 14 days subject to the approval of the Board of Governors in Washington.

Lender of Last Resort — As the nation's central bank, the Federal Reserve has the authority and financial resources to act as "lender of last resort" by extending credit to depository institutions or to other entities in unusual circumstances involving a national or regional emergency, where failure to obtain credit would have a severe adverse impact on the economy.

Reserve Requirements — Reserves that must be held against customer deposits of banks and other depository institutions. The reserve requirement ratio affects the expansion of deposits that can be supported by each additional dollar of reserves. The Board of Governors sets reserve requirements within limits specified by law for all depository institutions (including commercial banks, savings banks, savings and loan associations, credit unions, some industrial loan banks, and U.S. agencies and branches of foreign banks) that have transaction accounts or nonpersonal time deposits. A lower reserve requirement allows more deposit and loan expansion and a higher reserve ratio permits less expansion.

Reserves — Funds set aside by depository institutions to meet reserve requirements. For member banks, reserve requirements are satisfied with holdings of vault cash and/or balances at the Federal Reserve Banks. Depository institutions that are not members of the Federal Reserve System may hold their reserves in the same manner, or they may pass the reserve balances through a correspondent institution to the Federal Reserve Banks.

Velocity — The rate at which money balances turn over in a period for expenditures on goods and services (often measured as the ratio of GNP to the money stock). A larger velocity means that a given quantity of money is associated with a greater dollar volume of transactions.

Federal Funds — Reserve balances that depository institutions lend each other, usually on an overnight basis. In addition, Federal funds include certain other kinds of borrowings by depository institutions from each other and from Federal agencies.

Demand Deposit — A deposit payable on demand, or a time deposit with a maturity period or required notice period of less than 14 days, on which the depository institution does not reserve the right to require at least 14 days written notice of intended withdrawal. Commonly takes the form of a checking account.

Transaction Account — A checking account or similar account from which transfers can be made to third parties. Demand deposit accounts, negotiable order of withdrawal (NOW) accounts, automatic transfer service (ATS) accounts, and credit union share draft accounts are examples of transaction accounts at banks and other depository institutions.

Negotiable Order of Withdrawal (NOW) Account — An interest earning account on which checks may be drawn. Withdrawals from NOW accounts may be subject to a 14-day or more notice requirement although such is rarely imposed. NOW accounts may be offered by commercial banks, mutual savings banks, and savings and loan associations and may be owned only

by individuals and certain nonprofit organizations and governmental units.

Automatic Transfer Service (ATS) Account — A depositor's savings account from which funds may be transferred automatically to the same depositor's checking account to cover a check written or to maintain a minimum balance.

Deposit Ceiling Rates of Interest — Maximum interest rates that can be paid on savings and time deposits at federally insured commercial banks, mutual savings banks, savings and loan associations, and credit unions. Ceilings on credit union deposits are established by the National Credit Union Administration. Ceilings on deposits held by the other depository institutions are established by the Depository Institutions Deregulation Committee (DIDC). Under current law, deposit interest rate ceilings are being phased out over a 6-year period, ending in 1986 under the oversight of the DIDC.

Certificate of Deposit (CD) — A form of time deposit at a bank or savings institution; a time deposit cannot be withdrawn before a specified maturity date without being subject to an interest penalty for early withdrawal. Small-denominaton CDs are often purchased by individuals. Large CDs of $100,000 or more are often in negotiable form, meaning they can be sold or transferred among holders before maturity.

Small Saver Certificate — A certificate of deposit with a minimum maturity of 2½ years offered by banks and thrift institutions to individuals. The interest rate on these certificates is related to the average yield on 2½ year Treasury securities, in accordance with regulations issued by the Depository Institutions Deregulation Committee. There is no minimum denomination required on these certificates.

Money Market Certificate — A certificate of deposit in a minimum denomination of $10,000 with a maturity of six months. The interest rate on money market certificates is related to the yield on six-month Treasury bills, in accordance with regulations issued by the Depository Institutions Deregulation Committee.

Federal Reserve Notes — Nearly all of the nation's circulating paper currency consists of Federal Reserve notes printed by the Bureau of Engraving and Printing and issued to the Federal Reserve Banks which put them into circulation through commercial banks and other depository institutions. Federal Reserve notes are obligations of the U.S. Government.

Treasury Securities — Interest-bearing obligations of the U.S. Government issued by the Treasury as a means of borrowing money to meet government expenditures not covered by tax revenues. Marketable Treasury securities fall into three categories—bills, notes, and bonds. The Federal Reserve System holds more than $125 billion of these obligations, acquired through open market operations. Marketable Treasury obligations are currently issued in book-entry form only; that is, the purchaser receives a statement, rather than an engraved certificate.

Treasury Bills — Short-term U.S. Treasury securities issued in minimum denominations of $10,000 and usually having original maturities of 3, 6, or 12 months. Investors purchase bills at prices lower than the face value of

the bills; the return to the investors is the difference between the price paid for the bills and the amount received when the bills are sold or when they mature. Treasury bills are the type of security used most frequently in open market operations.

Treasury Notes Intermediate-term coupon-bearing U.S. Treasury securities having initial maturities from 1 to 10 years and issued in denominations of $1,000 or more, depending on the maturity of the issue. Notes pay interest semi-annually, and the principal is payable at maturity.

Treasury Bonds Long-term U.S. Treasury securities usually having initial maturities of more than 10 years and issued in denominations of $1,000 or more, depending on the specific issue. Bonds pay interest semi-annually, with principal payable at maturity.

Repurchase Agreements When the Federal Reserve makes a repurchase agreement with a government securities dealer, it buys a security for immediate delivery with an agreement to sell the security back at the same price by a specific date (usually within 15 days) and receives interest at a specific rate. This arrangement allows the Federal Reserve to inject reserves into the banking system on a temporary basis to meet a temporary need and to withdraw these reserves as soon as that need has passed.

Matched Sale-Purchase Agreements When the Federal Reserve makes a matched sale-purchase agreement, it sells a security outright for immediate delivery to a dealer or foreign central bank, with an agreement to buy the security back on a specific date (usually within 7 days) at the same price. Matched sale-purchase agreements are the reverse of repurchase agreements and allow the Federal Reserve to withdraw reserves on a temporary basis.

Fiscal Agency Services Services performed by the Federal Reserve Banks for the U.S. Government. These include maintaining deposit accounts for the Treasury Department, paying U.S. Government checks drawn on the Treasury, and issuing and redeeming savings bonds and other government securities.

Fiscal Policy Government policy regarding taxation and spending. Fiscal policy is made by Congress and the Administration.

Inflation A rise, over time, in the average level of prices.

Recession A significant decline in general economic activity extending over a period of time.

Productivity The amount of physical output for each unit of productive input.

payments mechanism

Payments Mechanism Systems designed for the movement of funds, payments and money between financial institutions throughout the nation. The Federal Reserve plays a major role in the nation's payments mechanism through distribution of currency and coin, check processing, wire transfers of funds

and the operation of automated clearing houses that transfer funds electronically among depository institutions. Federal Reserve payments mechanism services are made available to both member banks and nonmember depository institutions on the basis of uniform pricing schedules.

Check Clearing The movement of checks from the banks or other depository institutions where they are deposited back to those on which they are written, and funds movement in the opposite direction. This process results in credits to accounts at the institutions of deposit and corresponding debits to the accounts at the paying institutions. The Federal Reserve participates in check clearing through its nationwide facilities, though many checks are cleared by private sector arrangements.

Regional Check Processing Center (RCPC) A Federal Reserve check processing operation that clears checks drawn on depository institutions located within a specified area. RCPCs expedite collection and settlement of checks within the area on an overnight basis.

Clearinghouse An institution where mutual claims are settled between accounts of member depository institutions. Clearinghouses among banks have traditionally been organized for check-clearing purposes, but more recently have cleared other types of settlements, including electronic fund transfers.

Float Checkbook money that for a period of time appears on the books of both the payor and payee due to the lag in the collection process. Federal Reserve float often arises during the Federal Reserve's

check collection process. In order to promote an efficient payments mechanism with certainty as to the date funds become available, the Federal Reserve has employed the policy of crediting the reserve accounts of depository institutions depositing checks within a maximum of three business days of the deposit; however, more time may be needed to process certain checks and collect funds from the institutions on which these checks are drawn.

This policy results in credit being given to some depository institutions before the Federal Reserve is able to obtain payment from others. During 1983 new crediting procedures may be adopted, in conformance with the MCA, which are designed to reallocate or recover the value of float to depository institutions.

Electronic Fund Transfer Systems (EFTS) A variety of systems and technologies for transferring funds (money) electronically rather than by check. Includes Fedwire, Bankwire, automated clearinghouses (ACHs), and other automated systems.

Fedwire The Federal Reserve funds transfer system. Fedwire is used for transferring reserve account balances of depository institutions, and government securities. Fedwire is also used for the settlement of other clearing systems, such as CHIPS.

Clearinghouse Interbank Payments System (CHIPS) An automated clearing system used primarily for international payments. This system is owned and operated by the New York Clearinghouse banks. It engages Fedwire for settlement.

SWIFT A message writing system that connects worldwide participating banks primarily

for the purpose of communicating payment information. Frequently, the SWIFT message is only part of an international payment process which might also employ a system such as CHIPS to fully implement the transaction.

FRCS-80 The communications network of the Federal Reserve which interconnects Federal Reserve Bank offices, the Board of Governors, depository institutions and the Treasury. It is used for Fedwire transfers, transfers of U.S. securities, as well as for transfer of Federal Reserve administrative, supervisory, and monetary policy information.

Bankwire An electronic communications network owned by an association of banks and used to transfer messages between subscribing banks. Bankwire also offers a clearing service called Cashwire that includes a settlement facility.

Automated Clearinghouse (ACH) A computer based clearing and settlement operation, often operated by a Federal Reserve Bank, established for the exchange of electronic transactions among participating depository institutions. Such electronic transactions can be substituted for paper checks used to make recurring payments such as payroll or preauthorized insurance premiums. The U.S. Treasury uses the ACH extensively to pay certain obligations of the government.

Automated Teller Machines (ATMs) Computer-controlled terminals located on the premises of financial institutions or elsewhere, through which customers may make deposits, withdrawals, or other transactions as they would through a bank teller. Other terms sometimes used to describe such terminals are customer-bank communications terminal (CBCT) and remote service unit (RSU). Groups of banks sometimes share ATM networks located throughout a region of the country that may include portions of several states.

Debit Card A card that resembles a credit card but which debits a transaction account (checking account) with the transfers occuring contemporaneously with the customer's purchases. A debit card may be machine readable, allowing for the activation of an automated teller machine or other automated payments equipment.

foreign

Current Account Balance The difference between the nation's total exports of goods, services, and transfers and its total imports of them. It excludes transactions in financial assets and liabilities.

Trade Deficit Refers to the amount by which merchandise imports exceed merchandise exports.

Foreign Exchange Transactions Purchase or sale of the currency of one nation with that of another. Foreign exchange rates refer to the number of units of one currency needed to purchase one unit of another, or the value of one currency in terms of another.

Foreign Exchange Desk The foreign exchange trading desk at the New York Federal Reserve Bank. The desk undertakes operations in the ex-

change markets for the account of the Federal Open Market Committee, and as agent for the U.S. Treasury and for foreign central banks.

International Monetary Fund (IMF) An international organization with 146 members, including the United States. The main functions of the International Monetary Fund are to lend funds to member nations to finance temporary balance of payments problems, to facilitate the expansion and balanced growth of international trade, and to promote international monetary cooperation among nations. The IMF also creates special drawing rights (SDRs), which provide member nations with a source of additional reserves. Member nations are required to subscribe to a Fund quota, paid mainly in their own currency. The IMF grew out of the Bretton Woods Conference of 1944.

Special Drawing Rights (SDRs) A type of international money created by the IMF and allocated to its member nations. SDRs are an international reserve asset, although they are only accounting entries (not actual coin or paper, and not backed by precious metal). Subject to certain conditions of the IMF, a nation that has a balance of payments deficit can use SDRs to settle debts to another nation or to the IMF.

Eurodollars Deposits denominated in U.S. dollars at banks and other financial institutions outside the United States. Although this name originated because of the large amounts of such deposits held at banks in Western Europe, similar deposits in other parts of the world are also called Eurodollars.

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Bank for International Settlements (BIS) The BIS, located in Basle, Switzerland, was established in 1930 to administer the post-World War I reparations agreements. Since the 1960s, the BIS has evolved into an important international monetary institution, and has provided a forum in which central bankers meet and consult on a monthly basis. As an independent financial organization, the BIS performs a variety of banking, trustee, and agent functions, primarily with central banks. At present the BIS has 29 members, 28 of which are central banks. The Federal Reserve is represented at BIS meetings, but is not a member. The BIS is the only international financial institution in which most Eastern European countries are members. The Soviet Union, East Germany, and Albania, however, are not members.

Swap Arrangements Short-term reciprocal lines of credit between the Federal Reserve and 14 foreign central banks as well as the Bank for International Settlements. Through a swap transaction, the Federal Reserve can, in effect, borrow foreign currency in order to purchase dollars in the foreign exchange market. In doing so the demand for dollars is increased and the dollar's foreign exchange value is increased. Similarly, the Federal Reserve can temporarily provide dollars to foreign central banks through swap arrangements.

International Banking Facility (IBF) In general, these facilities can accept time deposits from foreign customers free of reserve requirements and interest rate limitations, and can lend to foreigners if the funds are for the conduct of foreign business outside of the U.S. Net borrowing from these facilities by domestic bank-

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ing offices is subject to reserve requirements.

consumer credit

Credit The promise to pay in the future in order to buy or borrow in the present. The right to defer payment of debt.

Creditworthiness A creditor's measure of a consumer's past and future ability and willingness to repay debts.

Credit History A record of how a person has borrowed and repaid debts.

Credit Scoring System A statistical system used to determine whether or not to grant credit by assigning numerical scores to various characteristics related to creditworthiness.

Credit Card Any card, plate, or coupon book that may be used repeatedly to borrow money or buy goods and services on credit.

Annual Percentage Rate (APR) The cost of credit on a yearly basis expressed as a percentage.

Finance Charge The total dollar amount paid to get credit.

Collateral Property that is offered to secure a loan or other credit and that becomes subject to seizure on default. (Also called "security".)

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Security Interest The creditor's right to take property or a portion of property offered as security.

Liability on an Account Legal responsibility to repay debt.

Default Failure to meet the terms of a credit agreement.

Open-End Credit A line of credit that may be used repeatedly up to a certain limit, also called a charge account or revolving credit.

Open-End Lease A lease that may involve a balloon payment based on the value of the property when it is returned. (Also called "finance lease".)

Balloon Payment A large extra payment that may be charged at the end of a loan or lease.

Cosigner Another person who signs for a loan and assumes equal liability for it.

Service Charge A component of some finance charges, such as the fee for triggering an overdraft checking account into use.

Points Finance charges paid by the borrower at the beginning of a loan in addition to monthly interest; each point equals one percent of the loan amount.

Seller's Points A lump sum paid by the seller to the buyer's creditor to reduce the cost of the loan to the buyer. This payment is either required by the creditor or volunteered by the seller, usually in a loan to buy real estate. Generally, one point equals one percent of the loan amount.

Buydown A lump sum payment made to the creditor by the borrower or by a third party to reduce the amount of some or all

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of the consumer's periodic payments to repay the indebtedness.

Overdraft Checking Account A checking account associated with a line of credit that allows a person to write checks for more than the actual balance in the account, with a finance charge on the overdraft.

Appraisal Fee The charge for estimating the value of property offered as security.

Variable Rate A variable rate agreement, as distinguished from a fixed rate agreement, calls for an interest rate that may fluctuate over the life of the loan. The rate is often tied to an index that reflects changes in market rates of interest. A fluctuation in the rate causes changes in either the payments or the length of the loan term. Limits are often placed on the degree to which the interest rate or the payments can vary.

Closed-End Credit Generally, any loan or credit sale agreement in which the amounts advanced, plus any finance charges, are expected to be repaid in full over a definite time. Most real estate and automobile loans are closed-end agreements.

Amortization The process of fully paying off indebtedness by installments of principal and earned interest over a definite time.

Fixed Rate A traditional approach to determining the finance charge payable on an extension of credit. A predetermined and certain rate of interest is applied to the principal.

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Renegotiable Rate A type of variable rate involving a renewable short-term "balloon" note. The interest rate on the loan is generally fixed during the term of the note, but when the balloon comes due, the lender may refinance it at a higher rate. In order for the loan to be fully amortized, periodic refinancing may be necessary.

Graduated Payment Repayment terms calling for gradual increases in the payments on a closed-end obligation. A graduated payment loan usually involves negative amortization.

Negative Amortization Repayment schedule calling for periodic payments that are insufficient to fully amortize the loan. Earned but unpaid interest is added to the principal, increasing the debt. Eventually, payments must be rescheduled to fully pay off the debt.

Wraparound A financing device that permits an existing loan to be refinanced and new money to be advanced at an interest rate between the rate charged on the old loan and the current market interest rate. The creditor combines or "wraps" the remainder of the old loan with the new loan at the intermediate rate.

Surcharge An extra charge imposed on those who purchase with a credit card instead of cash. (Currently, surcharges for credit card purchases are prohibited.)

Discount An amount deducted from the regular price for those who purchase with cash instead of credit.

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